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SUBJECT: BRAZIL'S REGIONAL CITIES FEEL THE EFFECTS OF THE GLOBAL  
ECONOMIC SLOWDOWN

REF: A. Sao Paulo 92 B. 07 Sao Paulo 754

SENSITIVE BUT UNCLASSIFIED - PLEASE PROTECT ACCORDINGLY

11. (SBU) Summary: Brazil's regional cities in Sao Paulo State and Minas Gerais are feeling the effects of the financial crisis. During a March 16-19 outreach visit to several interior cities, local business leaders indicated that the current financial crisis created a vicious cycle of falling exports coupled with tight financing. The falling exports caused revenue declines in selected industries, many of which are now laying-off workers. The tight credit markets also forced many companies, particularly in the sugar cane and ethanol sector, to delay large capital projects. All of these factors contribute to a decline in tax revenue for these regional cities. The cities with a more diversified economic base are faring better than some of their single-industry peers, but all are feeling the pain. However, even cities that focus on a single industry such as ethanol and sugar production believe the long-term prospects are good as sugar prices rebound and domestic ethanol demand continues to grow. End Summary.

REACHING OUT TO THE BRAZILIAN INTERIOR

12. (U) In a four day trip to smaller cities in the Brazilian interior, representatives from Pol/Econ, Consular and the U.S. Department of Agriculture conducted a series of economic, political and public outreach meetings. From March 16 - 19, representatives of ConGen Sao Paulo visited the cities of Ribeirao Preto and Franca in Sao Paulo State and Uberlandia and Uberaba in Minas Gerais State. Since this region is predominantly agrarian, they met with agribusiness leaders in the coffee, cattle and sugar cane/ethanol sectors. They also connected with industry representatives from the footwear and transportation logistics sectors. While in Uberlandia and Uberaba, they met with the Secretary for Economic Development and the Mayor, respectively, to learn how these cities are confronting the financial crisis and planning for the future.

SUGAR MILLS CONTINUE TO FACE TOUGH TIMES

13. U) Silvio Ortega of Pedra Agroindustria S.A.'s Biocycle subsidiary (near Ribeirao Preto) discussed the recent troubles in the sugar cane and ethanol industries with Consulate representatives noting that, for the first time in 20 years, several companies in the region filed for bankruptcy. The ethanol industry in Brazil remains fragmented and several players over-leveraged during expansion. With the 2007 and 2008 fall in sugar prices, followed

closely by the credit crisis, several large mills (notably Santa Elisa/Vale and Nova America- since bought by COSAN) are in dire straits (Reftel A). He noted that plans for new mills in the area are being delayed pending improvements in the financial markets. Moreover, Monika Bergamaschi, President of the Ribeirao Preto Chapter of the Brazilian Agribusiness Association (ABAG) noted that the capital goods & manufacturing sector in nearby Sertaozinho, a city heavily dependent on supplying equipment for new sugar mills, is at a standstill. Manufacturers have laid-off staff and struggle with heavy inventories and no new demand. Anderson Galvao, an independent agricultural consultant in Uberlandia noted that of the five new mills in the region scheduled to start operating this year, four had been postponed and the last is under review.

SINGLE-INDUSTRY-TOWNS SUFFER THE BRUNT

14. (U) The towns of Ribeirao Preto and Franca are experiencing the worst of the regional declines. The fate of Ribeirao Preto is closely linked to that of the sugar cane/ethanol industry while Franca relies heavily on shoe manufacturing (Reftel B). Jose Carlos Brigagao do Couto, President of the Franca Shoe Industry Syndicate (SindiFranca), noted that Franca is reeling from the dual effects of competition from cheap Chinese shoe imports and falling worldwide demand as a result of the financial crisis. He shared that export figures for January and February are down a staggering 70 percent from the prior year and domestic demand will not make up the difference. (Note: While Ribeirao Preto and Franca are clearly affected by the financial downturn, both experienced economic difficulties before the crisis hit. Falling sugar prices hit Ribeirao Preto in 2007 and 2008 and Franca's shoe industry badly

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needed consolidation and modernization well before the credit crunch. End Note.)

15. (U) Despite this negative news, unemployment, at least in Ribeirao Preto, is not expected to climb significantly. In meetings with industry representatives and University of Sao Paulo (USP) economist, Alberto Borges Matias, interlocutors noted that the sugar cane harvest would be collected and processed regardless of the economic climate. The mills will commence processing as normal in April and May in an effort to generate cash flow. Borges Matias added that he observed a loosening in credit lines in the region and that he expects to see Brazil retreat to import-substitution measures to prop up employment in the medium term.

DIVERSIFIED PORTFOLIO CRITICAL IN A DOWN MARKET

16. (U) A visit to Uberlandia and Uberaba revealed a different economic scenario than Ribeirao Preto. Uberlandia Secretary of Economic Development, Rafael Porto, noted that while the economy in his region is highly dependent on agriculture, the base is more diverse than Ribeirao Preto. In addition to sugar cane production, Uberlandia is known for coffee, soy, and corn. There are also strong dairy, swine, and chicken industries. Due to Uberlandia's location in the center of Southern Brazil, it has developed a strong logistics industry and receives significant revenue from the trucking and transportation sectors. Leveraging this proximity to a trucking hub, a number of wholesalers have bases in Uberlandia and their business is, according to Paulo Vitiello Filho, Vice President for the Chamber of Logistics Leaders (CDL), "booming."

17. (U) Uberaba has not made as much progress in diversifying its economy as Uberlandia, but it does have a more widespread agricultural base. Interlocutors believe it will be able to weather the current financial storm. Uberaba mayor, Anderson Adauto, noted that while the region's soy and corn sales are strong, it is experiencing a decline in civil construction and petrochemicals (mostly fertilizer). Concomitantly, tax revenues are down 11 percent year over year and the city is re-examining its budget.

COMMENT

¶8. (SBU) Despite some of the negative economic news, the long term outlook for these cities (excluding Franca) remains positive. The industries and cities that are suffering today were grappling with their problems well before the current crisis began. Last year's poor sugar crop in India is raising sugar prices worldwide, and strong domestic ethanol demand should alleviate some of the pressure on the sugar cane/ethanol industry as well as the cities that depend on the revenue streams they generate. End Comment.

¶9. (U) This cable was cleared by The U.S. Consulate in Rio and the U.S. Department of Agriculture in Sao Paulo.

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